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## CAPITALIZATION OF EARNINGS OF PUBLIC SERVICE COMPANIES

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The expediency of adjusting the powers and privileges of monopolies, like our railroads, telephones, gas, electric light and water companies, to the ascertained requirements of the public and to the conditions which govern and secure to the companies themselves their own stability and efficiency has passed beyond the debatable point; for about all the states of the Union have, in response to the reasonableness and advisability of this expediency, created commissions for the supervision and regulation of public utilities which from the nature of the field of their operations are necessarily monopolies.

The only aim and purpose of these commissions are to secure two things, namely, the lowest price for an adequate service rendered, and the permanence and security of the investment. The body of principles to be observed in securing these mutual benefits is called public policy and this (it goes without saying) like any political agency has to adapt itself to circumstances and the growth of enlightened public opinion.

Let us bring into light with as much clearness as we can the factors on which the lowest possible prices depend and the conditions most favorable for the security and permanence of the investment.

The vital relation which the fitness and adaptation of the plant as a whole to its environment, its output, its situation in regard to the cost of material and labor, the zeal and intelligence with which its operations are carried on to the question of low prices are so obvious as to need no elaboration. They are facts, however, which, save in the matter of technical skill displayed in operation, are entirely local and beyond the control of either the company or the state, and the advantages and disadvantages they impose must be shared or borne by the community and the investment. But,

assuming the conditions that have prevailed and still prevail in the cities of our country that have been attended by a long and uninterrupted prosperity for our gas, electric light and water companies, and also that the tendency of monopoly to grow stagnate and indifferent through not feeling the spur of competition has been resisted and improvements and extensions have been attended to with public spirit, then it is equally obvious that the lighter the capital burden the lower may and should be the prices of the manufactured or supplied article to the consumer. Now as to capitalization:

In view of the fact that the issue of the securities of public service corporations is a joint exercise of authority vested by law in the directors of public service companies and the supervising commissions, the capital burden as a legalized creation is wholly in their hands, and hence the responsibilities as to the effect of its magnitude on consumer and investor must fall on the official bodies who give it lawful existence. What then are the duty and the opportunity of directors and commissions to do a great service to the public by making the burden on the helpless consumer the lightest, his prospect for the lowest prices the brightest and the investors' interest for permanency and security the safest! To accomplish this public-spirited end no labor is too great and none too little to be undergone by commissions and directors; for, with their hearty coöperation there must, or at least *should* follow, good will on the part of the public and solidly progressive stability and usefulness of the companies.

It cannot be conceived that there is place for discussion over the postulate that between two companies, one with and one without a substantial surplus in the plant, that the former is in every way the better for consumer and investor. If this be granted, and a little reflection be given to the matter, the question of capital and devotion of earnings ceases to be academic and boils down to one that is practical and one of business, namely, how shall a surplus with its potential strength be created and preserved, and what shall be the limit for its sufficiency?

A surplus, as we all know, is the fruit of profits, and, in the first instance, has no other source; later, however, it bears a fruit of its own in the way of premium which new incoming capital pays to enjoy the advantages of the old capital. Surplus has its being then as the result of prices; and as the prices which the directors of our gas and electric light and water companies set at such figures as

they see fit, and, without discussing for the moment the reasonableness of these unrestrained established prices as effecting a collective interest of the community in the enterprise, the devotion of resultant profits is equally an unrestrained exercise of the directors' volition. It is in their hands, after interest charges are paid, to say how much shall be distributed to the stockholders, and how much shall go back into the plant to create or maintain a surplus. So if a company has no surplus it is the fault of the directors and whatsoever good may come from it to community and to the investor is lost. This is a fact of such consequence that commissions should have the power, where companies are not creating a surplus over actually paid-up capital or are depleting one that has been created, to intervene and reduce dividends until the property has gained or regained a workable surplus. In the early days of our gas and electric companies such prices were fixed and conservative policies pursued as to dividends, that the result was that the companies in our growing cities had more or less substantial surpluses, with corresponding increase in the value of the stock.

Then, unfortunately for the consumer and to the misfortune of many an investor, came the day of reckless speculation in the securities of our gas and electric companies. For suddenly a band of financial adventurers, headed by Addicks, invaded the field. The old stockholders, who with courage and shrewdness had built up the plants, unwilling to face unscrupulous enemies, sold out at great profit, and, having seized control, the buyers at once began to prey on the surpluses by converting them into first and second mortgage bonds, preferred and heavily watered stock. This astounding exhibition of high finance, capitalizing not only surpluses but future earnings, has aroused the public to a thoughtful and serious inquiry as to its rights in these surpluses and the devotion of the monopolies' earnings. Hence the conflict, now raging before the courts between the speculators in our gas and electric companies and the public, became inevitable.

The legal battle ground is over two propositions: has the public that has created these surpluses, in addition to paying fair dividends, a collective interest in them which in the nature of things can only be reflected in rates? The second is: is the obligation of their capital burden based on the paid-up capital that has come out of the pockets of stockholders, or are they bound to pay on valua-

tions, including organization charges, overhead charges, franchise and going concern values, made by professional experts hired by the companies, on the one hand, and by the public on the other hand? I think that sooner or later our courts will falter before this proposition. For if it be finally held by our courts in rate cases that the reproductive value of the plant is the unqualified measure of the consumers' burden, regardless of the amount paid in by stockholders out of their own pockets, then there would seem to be little call for the state to bother itself about the issues of securities, either as to their amount or the conditions under which they may be authorized. Once the experts' figures thrown in the balance are the determining factors for justice, what becomes of the weight of public policy and the financial history of the surplus?

Some light is thrown on this battle ground in Massachusetts from the policy of the state itself and from the decisions of its board. As early as 1867 the state prohibited the capitalization of profits. In 1894 the board in a decision, ordering a reduction of rates, had this to say as to the obligation of consumers which touches the question of capitalization and devotion of earnings:

When gas reaches the consumer it is burdened with three obligations: first, its fair cost; second, a fair dividend on a reasonable amount of capital; and third, such excess as will give the company sufficient surplus to enable it to meet extraordinary accidents and conduct its business with the highest economy. The consumer is in duty bound to pay these charges. If he pays more and the company converts this excess into new capital, increasing it to a figure beyond the fair amount demanded by the business, the consumer is burdened with too high a price for the gas in the first instance and thereafter with a dividend charge upon his own contributions. A company which pursues this policy and to this extent fails to appreciate its obligations to its customers must sooner or later pay the penalty. The growth of the company's capital and its policy in reference thereto are recognized by this board as facts which it is proper and necessary to consider in adjusting complaints by consumers.

Finally I believe that commission regulation cannot be successful without guarding against an excess of capital, and that rates fixed either by courts or commissions must reflect the consumers' inalienable equity in whatsoever there may be in the plant which they directly, or society indirectly, may have contributed in the way of accretions to values.